

Northern India Textile Mills' Association

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Respected Sir,

Subject: An Important GST Issue: Textile Industry being denied refund of excess ITC due to inverted duty structure of goods & supplies due to preferential adjustment of excess ITC due to inverted duty structure against output liability.

We, Northern India Textile Mills' Association (NITMA) is an association of Textile Mills located in Northern India and was established in the year 1958. It is registered under Societies Act XX1 of 1860 and is a non-profit body solely engaged in helping promote the interests of Indian Textile Industry not only in the northern part as the name suggests but also in central and western states of the country.

NITMA is serving the interest of textile units for more than Six decades. Many of the large, medium and small textile industries located in northern India are associated with NITMA with the combined turnover of Rs. 50,000 Crores and represents approx 20% of textile production capacity.

A huge amount of working capital has got blocked in the processing, fabric and garments industry which has an inverted duty structure. This blockage of funds is mainly in the MSME sector, where extensively job working services are availed for stitching, knitting, weaving printing, embroidery, common effluent services, etc.

Despite refund of inverted duty being allowed, however due to job working being categorised as services the reality is that no refund is coming and hence the same is being passed on to next person in the chain making the overall cost structure of Indian textiles expensive and impacting exports and attracting imports.

With reference to the above subject-matter, we give a brief background that in the case of refund on account of inverted duty structure, refund of input tax credit is to be granted as per the following formula under Rule 89(5) of the CGST Rules 2017 and under Form RFD-01:-

Maximum Refund Amount = {(Turnover of inverted rated supply of goods and services) X Net ITC ÷ Adjusted Total Turnover} - tax payable on such inverted rated supply of goods and services.

- a) Net ITC means the input tax credit availed on inputs during the relevant tax period.
- b) Turnover of inverted rated supply of goods and services refers to that turnover on which the rate of outputs is lower than the rate of inputs

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- c) Adjusted total turnover refers to the turnover as calculated under Rule 89(4)
- d) The tax which is computed on the outward supply of the goods and services subjected to inverted rate is deducted in the formula above.

Issue:

- 1) As per the given formula, it is always assumed that the output taxes paid on supply of goods and services is to be first set off against Input tax credit availed on inputs without considering the Input tax credit on input services at all. This logic suffers from legal infirmity as such requirement has not been stated either in the Act or the rules.
- 2) Any industry with significant input services do not get to utilize the input tax credit on them. As these credits are not utilized and there is no mechanism to get a refund on the same, it results in such taxes being a cost to them. This is particularly applicable in the textiles industry wherein the input job work services form a significant portion of the total input tax credit availed.
- 3) The intent of the law has been to provide refund of the complete Input tax credit which is getting accumulated on account of input rate being greater than output rate. It does not cast a restriction on the manner of utilization of input tax credit for the payment of output taxes. The restriction of utilization emerging from the formula goes against the very objective of the refund provisions.
- 4) The message conveyed through the formula seems to suggest that no part of input services can be used to make payment of output tax liability. This anomaly should be removed and the relevant portion of ITC on input services should be allowed as utilization against output tax liability.

Suggestions:

- 1) In a situation where output tax is to be paid against the available input tax credit of a person, it is only logical that a person should have the alternative of choosing the relevant input tax credit which is to be used for such payments.
- 2) If there has to be a single methodology prescribed for utilization of input tax credit, the complete ITC on input services should first be allowed as utilization against payment of output taxes. This will eliminate any unnecessary accumulation and blockage of ITC which is currently taking place.
- 3) The formula should be amended in Rule 89(5) and Form GST RFD-01 as follows:

Maximum Refund Amount = {(Turnover of inverted rated supply of goods and services) X Net ITC ÷ Adjusted Total Turnover} – (tax payable on such inverted rated supply of goods and services – ITC utilized on input services for payment of output tax)

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Illustration:

| Particulars | Amount | Rate of Tax | Taxes |
|-----------------------------------|--------|-------------|-------|
| Inward supplies on inputs | 1000 | 18% | 180 |
| Inward supplies on input services | 200 | 5% | 10 |
| Turnover on inverted rated supply | 1300 | 12% | 156 |

Ans: Accumulated ITC = Rs.180 +10 – 156 = Rs.34

Current Formula

The refund as per the current formula is:

Maximum Refund Amount = {(Turnover of inverted rated supply of goods and services) X Net ITC ÷ Adjusted Total Turnover} - tax payable on such inverted rated supply of goods and services.

$$\begin{aligned} &= (1300*180/1300) - 156 \\ &= \text{Rs. 24} \end{aligned}$$

Thereby as per the current formula, the complete ITC on input services becomes a part of accumulated ITC though the same could have been utilized against payment of output tax liability.

Proposed Formula

Maximum Refund Amount = {(Turnover of inverted rated supply of goods and services) X Net ITC ÷ Adjusted Total Turnover} – (tax payable on such inverted rated supply of goods and services – ITC utilized on input services for payment of output tax)

$$\begin{aligned} &= (1300*180/1300) - (156 - 10) \\ &= \text{Rs. 34} \end{aligned}$$

After the implementation of the proposed formula, there will be no unnecessary blockage of input tax credit. The entire ITC on input services will be considered to have been utilized against payment of output tax liability and only the balance of ITC remaining on inputs are arising as a refund.

We look forward to your kind support and cooperation in addressing the above issue.

Thank You.

With kind regards

Rajiv Garg
President